DEPARTMENT OF STATE REVENUE

Revenue Ruling #2011-03 ST
October 11, 2011

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ISSUES

Sales and Use Tax – Telephone Replacement Program

A company ("Taxpayer") is seeking an opinion as to whether the provisions of a telephone replacement program are subject to Indiana sales and use tax.

Authority: IC 6-2.5-2-1; IC 6-2.5-3-2; IC 6-2.5-4-1; Sales Tax Information Bulletin #2 (December 2006)

STATEMENT OF FACTS

Taxpayer provides the following facts regarding its request for a revenue ruling. Taxpayer currently provides a non-optional telephone replacement program ("TRP") for its customers who purchase a qualifying wireless service plan ("WSP"). The program is a combination of a service contract ("Service Contract") and an insurance policy ("Insurance Policy") underwritten by a third party ("Insurance Company"). The TRP offers taxpayer's customers protection in the case of accidental damage, mechanical breakdown, and lost or stolen telephones. In particular, Taxpayer provides the following details:

> **Phone Replacement Program Background and Structure**
>
> [Taxpayer] currently offers the [TRP] as one of many non-optional features it includes in its premium wireless plans (referred to as "Enhanced Plans"). The [TRP] is not sold separately and is available only with the Enhanced Plans. For regulatory reasons, [Taxpayer] has entered into an agreement (the "Agreement") arranging for [Insurance Company] to provide the coverage under the [TRP]. The [TRP] consists of two distinct parts: (i) a non-contributory group Service Contract that covers certain handset mechanical or electric failures, accidental water and certain other specified damages, and (ii) a non-contributory group Insurance Policy that covers lost or stolen handsets. (Emphasis in original.)
>
> [Taxpayer] pays [Insurance Company] a single premium of a specified amount per month per [TRP] subscriber (a "Subscriber") (the exact figure varies depending on the number of total Subscribers) for both the Service Contract and the Insurance Policy. Upon enrollment, a Subscriber–
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> (i) Becomes a direct contracting party with [Insurance Company] under the Service Contract and is provided the Service Contract Terms and Conditions, and
> (ii) Becomes a certificate holder (i.e., a beneficiary) of the Insurance Policy, which is underwritten by [Insurance Company], and is provided with a Wireless Protector Certificate Declaration and a Wireless Protector Certificate of Insurance. (Emphasis in original.)
>
> In both cases, [Taxpayer] pays the premium (on behalf of the Subscribers, in the case of the Service Contract)–for which no separate charge is ever made to the Subscriber–and [Insurance Company] is the obligor.
>
> Under the Service Contract the Subscriber must exchange the damaged phone for the Replacement Phone, but pays no deductible. In contrast, under the Insurance Policy, a Subscriber whose phone is lost or stolen pays a $100 deductible and receives a new phone (the "Replacement Phone").
>
> Under both programs, the Replacement Phone will be the same as or similar to the lost, broken, inoperable, or damaged phone. Subscribers do not receive upgraded phones. Pursuant to its obligation under the Agreement, [Taxpayer] maintains a pool of new and used phone (the "Pool") from which it provides Replacement Phones to Subscribers. [Taxpayer-owned] stores maintain a small supply of Replacement Phones for walk-in Subscriber claimants, which phones are treated as part of the Pool. As explained further below, phones turned in by Subscribers pursuant to the Service Contract are refurbished and added to the

Pool, to be provided as Replacement Phones.

Customer Enrollment and Billing

A [Taxpayer] wireless customer who purchases a [Taxpayer] handset and signs up for an Enhanced Plan is automatically enrolled as a "Subscriber" in the [TRP]. Upon enrollment, a Subscriber receives an enrollment package directly from the program provider, [Insurance Company]. It is possible for a wireless customer to decline enrollment, but the customer receives no reduction in the price of his or her (referred to hereafter as "his") monthly plan for doing so, and [Taxpayer] does not offer a lower-price plan that differs only by its exclusion of the [TRP]. (Emphasis in original.)

The [TRP] is listed on the Subscriber's wireless bill as a feature of the Enhanced Plan, but the bill is not itemized. There is a single, bundled charge for all of the services included in the Enhanced Plan (the "Wireless Monthly Fee"), including voice, messaging, data, Internet access (if applicable), the [TRP], and loyalty points.

The Wireless Monthly Fee, including the [TRP], is generally subject to sales tax and utility services tax. Internet access is nontaxable under the Internet Tax Freedom Act ("Nontaxable Internet Service"), except in a few states that were grandfathered. To that end, the Streamlined Sales Tax Act and the federal Mobile Telecommunications Sourcing Act exclude from tax that portion of the bundled Wireless Monthly Fee allocable to Nontaxable Internet Service. [Taxpayer] has determined that a portion of the data supplied over its wireless network qualifies as Internet access. Other than in those grandfathered states, a small portion of the Wireless Monthly Fee is accordingly allocated by [Taxpayer] each month to Nontaxable Internet Service and is not subject to tax.

Claims Processing and Handling

A claim under the [TRP] is initiated when a Subscriber submits a request at a [Taxpayer] retail store, or files a claim through [Taxpayer's customer service center] over the phone. The claim is then submitted to [Insurance Company] for adjudication and administration. The steps involved in claim fulfillment depend on whether a claim is submitted under the Service Contract or the Insurance Policy.

Service Contract Claim. We first address a claim filed by a Subscriber under the Service Contract, which allows Subscribers to return certain damaged phones for a Replacement Phone. Assuming the damage is covered under the Service Contract, [Taxpayer] will, upon receiving direction from [Insurance Company], take the damaged phone from the Subscriber (which must be provided in the case of a claim under the Service Contract) and replace it with a phone from the Pool. If the claim is submitted in person at a [Taxpayer] store, and is approved by [Insurance Company], a Replacement Phone will be given immediately out of the Pool of phones at the [Taxpayer] store. If no Pool phone is available, one is shipped overnight to the Subscriber from the pool maintained at [Taxpayer's] third party fulfillment center.... If the claim is submitted via telephone and approved by [Insurance Company], the Replacement Phone is shipped overnight to the Subscriber. In that case, the Subscriber must ship the broken or damaged phone to [Taxpayer], or be charged the full undiscounted retail price of the Replacement Phone. [Taxpayer] gives the Subscriber an invoice showing that the Replacement Phone has been exchanged for the Subscriber's damaged phone, and that no balance is due. The customer pays no deductible for Service Contract claims. (Emphasis in original.)

[Insurance Company] pays [Taxpayer] a "Handset Reimbursement Fee" in the amount of $188 for each Replacement Phone [Taxpayer] provides to a Subscriber at [Insurance Company's] direction. [Taxpayer] retains the broken or damaged phone and refurbishes it. If the refurbishing is successful, the phone is added to the Pool; otherwise, it is sold for scrap.

Insurance Policy Claim. Because the Insurance Policy covers lost or stolen phones, Subscribers submitting claims under the Insurance Policy do not have a phone to turn in. Rather, Subscribers pay a $100 deductible. Once a claim is accepted, a Subscriber receives a Replacement Phone. If an Insurance Policy claim is submitted in person at a [Taxpayer] store, a Replacement Phone will be given immediately out of the Pool phones at the store. If no Pool phone is available, one is shipped overnight to the Subscriber from the pool maintained at [Taxpayer's] third party fulfillment center.... [Taxpayer] invoices [Insurance Company] $188 for the Replacement Phone. In satisfaction of this invoice, [Taxpayer] retains the $100 deductible paid by the Subscriber, and [Insurance Company] pays [Taxpayer] the $88 balance.

Based on the foregoing facts, Taxpayer requests the following rulings:

1. Under the Service Contract, no sales tax or use tax is imposed on Taxpayer, the Subscribers, or Insurance Company, for the provision of Replacement Phones to Subscribers at the direction of Insurance Company under the Service Contract for which Insurance Company provides to Taxpayer a "Handset Reimbursement Fee" in the amount of $188; and
2. Under the Insurance Policy, only the $100 deductible is subject to sales tax. No other sales tax or use tax is imposed on Taxpayer, the Subscribers, or Insurance Company, for the provision of Replacement Phones to Subscribers at the direction of Insurance Company under the Insurance Policy for which Insurance Company provides to Taxpayer a "Handset Reimbursement Fee" in the amount of $88. In such transactions, Taxpayer should collect from the Subscriber and remit sales tax on the $100 deductible.

DISCUSSION

In general, the Department's Sales Tax Information Bulletin #2 (December 2006) provides the following guidance on the application of Indiana sales tax to warranties:

> Original manufacturer warranties or dealer warranties warranting the condition of a product and providing that maintenance or replacement parts will be provided for either no charge or a flat charge are subject to sales tax. Original manufacturer warranties and dealer warranties not offered as an option when the product is sold are considered part of the selling price of the product. Any parts transferred to a buyer under the terms of an original manufacturer warranty or dealer warranty are not subject to sales tax because the parts and or property are considered to have been sold with the product as a part of the retail transaction on which sales tax was collected.

In the case of the Service Contract, Taxpayer charges, collects, and remits sales tax on the taxable portion of the Wireless Monthly Fee, which includes the value of the TRP and, therefore, the Service Contract. Since Taxpayer charges, collects, and remits sales tax on the full charge associated with the Service Contract, there is no sales tax or use tax is imposed on Taxpayer, the Subscribers, or Insurance Company, for the provision of Replacement Phones to Subscribers at the direction of Insurance Company under the Service Contract for which Insurance Company provides to Taxpayer a "Handset Reimbursement Fee" in the amount of $188.

In the case of the Insurance Policy, Taxpayer charges, collects, and remits sales tax on the taxable portion of the Wireless Monthly Fee, which includes the value of the TRP and, therefore, the Insurance Policy–excluding the $100 deductible paid by Subscribers under the policy. The $100 deductible also represents an amount paid for the TRP, albeit a separate amount from the fee subjected to sales tax as part of the Wireless Monthly Fee. Accordingly, the $100 deductible is subject to sales tax. However, the $88 paid by Insurance Company to Taxpayer under the Insurance Policy is not subject to sales or use tax. As noted above, a portion of each Subscriber's bill is for the TRP, the charges for which have already been subjected to tax as part of the Wireless Monthly Fee. Accordingly, other than the application of sales tax on the $100 deductible, no other sales tax or use tax is imposed on Taxpayer, the Subscribers, or Insurance Company, for the provision of Replacement Phones to Subscribers at the direction of Insurance Company under the Insurance Policy for which Insurance Company provides to Taxpayer a "Handset Reimbursement Fee" in the amount of $88. In such transactions, Taxpayer should collect from the Subscriber and remit sales tax on the $100 deductible.

RULING

Under the Service Contract, no sales tax or use tax is imposed on Taxpayer, the Subscribers, or Insurance Company, for the provision of Replacement Phones to Subscribers at the direction of Insurance Company under the Service Contract for which Insurance Company provides to Taxpayer a "Handset Reimbursement Fee" in the amount of $188.

Under the Insurance Policy, only the $100 deductible is subject to sales tax. No other sales tax or use tax is imposed on Taxpayer, the Subscribers, or Insurance Company, for the provision of Replacement Phones to Subscribers at the direction of Insurance Company under the Insurance Policy for which Insurance Company provides to Taxpayer a "Handset Reimbursement Fee" in the amount of $88. In such transactions, Taxpayer should collect from the Subscriber and remit sales tax on the $100 deductible.

CAVEAT

This ruling is issued to the taxpayer requesting it on the assumption that the taxpayer's facts and circumstances as stated herein are correct. If the facts and circumstances given are not correct, or if they change, then the taxpayer requesting this ruling may not rely on it. However, other taxpayers with substantially identical factual situations may rely on this ruling for informational purposes in preparing returns and making tax decisions. If a taxpayer relies on this ruling and the Department discovers, upon examination, that the fact situation of the taxpayer is different in any material respect from the facts and circumstances given in this ruling, then the ruling will not afford the taxpayer any protection. It should be noted that subsequent to the publication of this ruling a change in statute, regulation, or case law could void the ruling. If this occurs, the ruling will not afford the taxpayer any protection.

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